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In the Supreme Court of the United States

October Term, 1984

SYLVESTER MARX, Individually, and as a shareholder of Centran Corporation, on behalf of Centran Corporation and all others similarly situated,
Petitioner,

VS.

CENTRAN CORPORATION, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

JOINT BRIEF OF ALL RESPONDENTS IN OPPOSITION

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INTRODUCTION

Central National Bank of Cleveland ("CNB" herein) is a national banking association directly chartered by the United States, rechartered with broader powers in 1971. Centran Corporation ("Centran" herein) is the present name of a Delaware corporation chartered in 1970. It is a duly registered bank holding company. All of the investment activities at issue were conducted exclusively by CNB and supervised, managed and controlled by its Board of Directors. Both Centran and CNB are nominal defendants, in that plaintiff brought his derivative action on behalf of and for the benefit of both CNB and Centran.

Sylvester Marx ("Marx" herein), Plaintiff and Petitioner, bought 200 shares of Centran's 4,000,000 common shares in the open market in 1978. He was never a shareholder in CNB. He maintained his stock ownership until October 29, 1984, when he transferred ownership to a Trustee. He died soon after the affirmance by the Court of Appeals.

The individual defendants against whom damage recovery was sought constitute most of the directors and some of the officers of both Centran and CNB. All the original defendants remain Respondents herein. All the Respondents submit this joint Brief in Opposition.

COUNTERSTATEMENT OF THE CASE

The original case was filed on multiple theories, and new theories of statutory violation were added in early briefs on various motions. Petitioner's First Amended Complaint alleged violations of 12 U.S.C. §§24, 82, 84, 375b and 1842(d), and violation of the Comptroller's regu-

lation 12 C.F.R. §1.4. A right of action was claimed under 12 U.S.C. §§93(a), 93(b), 1847 and 1849. The stock sale transaction with Marine Midland Bank, Inc. ("MMBI" herein) was pleaded as a violation both of 12 U.S.C. §1842 (d) and the pre-emptive rights of Centran shareholders. In later briefing plaintiff Marx gave notice of intention to amend to include violations of securities law, 15 U.S.C. §§77q and 78j, and a violation of 12 U.S.C. §371c. In the Court of Appeals plaintiff invoked a cause of action under 12 U.S.C. §1846, and added 12 U.S.C. §501a in this Court.

All of the above statutes and regulations are still claimed by Petitioner to support a direct action for Marx and a class action for Centran shareholders under Count I; a derivative action on behalf of and for the benefit of Centran or alternatively CNB under Count II; and a state law action for breach of fiduciary duty under Count III. Every issue under every statute is here presented for review on the petition for writ of certiorari. In addition, Petitioner submits in this Court a new constitutional issue questioning the limits of a national bank's right to borrow money to buy United States bonds.

New issues as to Petitioner's standing to appeal, and as to substitution of a party plaintiff, have arisen since the affirmance by the Court of Appeals on November 8, 1984. Marx, the sole plaintiff, died on November 20, 1984. At death he became no longer the owner of the 200 Centran shares which gave him standing to pursue the derivative claims.

There should be no dispute as to the facts on any issue. As soon as the Amended Complaint was filed, the parties agreed to a massive voluntary discovery in which Centran and CNB produced every document, record, chart, report or memorandum in their files and archives which was

material or relevant to the Incremental Securities Portfolio Program of 1980, or to any of the other issues on lending limits, borrowing limits, the MMBI transaction, pre-emptive rights, and the 1970-1971 mergers. The parties then stipulated the authenticity of all documents and summarized the relevant facts in lengthy Stipulations of Fact which in turn were enlarged as briefing proceeded.

The defendants moved for Summary Judgment in the District Court on all the claims for direct damages to the Centran shareholders in the individual action and class action under Count I. The District Court granted Summary Judgment on this Count. This necessarily ended the derivative action of Count II, since Centran as the shareholder of CNB itself had no private right of action against the CNB directors and officers to support either a derivative or double-derivative case.

The District Court dismissed the state law action pleaded in Count III, but without prejudice to plaintiff's right to refile in state court. The basis for the dismissal was that no federal action remained to which Count III remained pendent.

Plaintiff appealed on all three counts to the Court of Appeals for the Sixth Circuit. Before filing his brief he filed a petition for writ of certiorari in the Supreme Court of the United States, Case No. 83-615, invoking this Court's Rule 18. Certiorari was denied at that time. The appeal was briefed and argued in regular order in the Court of Appeals, which affirmed the District Court order on every point on November 8, 1984. En banc hearing was denied and rehearing was denied on January 8, 1985.

The District Court's Memorandum of Opinion is published in Petitioner's Appendix at pp. A2-24. The Opinion itself contains the text of most of the statutes and

regulations pleaded by plaintiff or suggested in plaintiff's briefs as an alternate ground of recovery. The opinion of the Court of Appeals is published in Petitioner's Appendix at pp. A62-A91. (It is also reported in 747 F.2d 1536.) It likewise covers every statute and regulation cited by plaintiff-appellant, answers all of the multiple theories presented to justify recovery, and presents authorities in addition to those cited in the District Court opinion and the defense briefs. It would be a shameful waste of this Court's time for Respondents to repeat or paraphrase all the content of the excellent opinions just to prove there is no conflict between the decision in this case and any other decision at any federal level. Respondent will simply address the new theories, or new interpretations of the fact stipulations, presented in Petitioner's brief in support of his petition for writ of certiorari.

SUMMARY OF ARGUMENT

The facts presented to the District Court establish beyond dispute that none of the Respondents has violated a single statute pleaded or briefed by Petitioner. The real issue in the case is whether Petitioner has a private right of action for violation of a regulation of the Comptroller of the Currency. The facts establish a genuine dispute whether the bank directors and officers did, or did not, exercise the prudent banking judgment which is required by 12 C.F.R. §1.4 in a bond purchase program.

If the regulation was violated, the statutory plan of 12 U.S.C. §93(b) gives exclusive power to the Comptroller to charge the violation, hold hearings, and impose or remit a civil penalty payable to the Treasury. Congress did not

grant a private right of action to enforce regulations. The test factors for determining Congressional intent on the private right of action issue have been thoroughly elaborated by this Court in a series of decisions. The District Court and Court of Appeals complied with this Court's standards in every respect.

Petitioner raises an issue on violation of pre-emptive rights which is baseless. Centran shareholders had no pre-emptive rights. Ohio's corporate code provisions regarding pre-emptive rights of shareholders in Ohio corporations cannot engraft pre-emptive rights into the stock of Delaware corporations issued under Delaware's corporation code.

Petitioner claims a constitutional issue arising under the Fifth Amendment. The theory presented is that a shareholder's derivative lawsuit is a personal property right which cannot be converted to public use without compensation and without due process of law. That is irrational. National banks are instruments of national government, subject to the paramount authority of Congress.

Petitioner has raised an issue of standing, since the individual plaintiff died over four months before the petition for writ of certiorari was filed. No motion for substitution is pending in this Court. Counsel for Petitioner demands, as a condition precedent to substitution, that the Court of Appeals or this Court must hold a trial in equity to rescind a stock transfer and order the original Marx shares to be administered in his probate estate. The issue should be ignored. It has not been properly presented and there is no record upon which an appellate decision can be based.

ARGUMENT

REASONS FOR DENYING THE WRIT OF CERTIORARI

Reason 1. There Is No Genuine Dispute As to Any Material Fact and No Conflict in the Decisional Law As to Any Issue Arising Under 12 U.S.C. §24 Seventh, §82, §84 or §93(a).

A. 12 U.S.C. §24 Seventh

Chapter 2 of Title 12 is designated the National Bank Act. It comprises §§21 through 215b. Section 24 deals with the corporate powers of national banks. The subsection, §24 Seventh, is the grant of incidental powers "necessary to carry on the business of banking." With respect to dealing in securities, banks, in general, can only buy and sell for their customers' accounts, but "the association may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe."

There is a special provision in §24 Seventh with respect to government bonds, which provides:

> "The *limitations and restrictions* herein contained as to dealing in underwriting, or purchasing for its own account, investment securities *shall not apply* to obligations of the United States, or general obligations of any State or of any political subdivision thereof. * * *" (Emphasis added)

The Comptroller designates obligations of the United States and general obligations of any State or its political subdivisions as "Type I" securities. The parties stipulated that:

> "The Court may * * * treat the Securities Portfolio increase in Municipal Bond holdings as though all purchases with short term borrowings were purchases of Type I securities."

CNB could not violate §24 Seventh regardless of the amount of such securities it bought for its own Portfolio account in 1980. There is a regulation of the Comptroller, 12 C.F.R. §1.4, sometimes called the Rule of Prudence, wherein the Comptroller allows unlimited dealing in Type I securities "subject only to the exercise of prudent banking judgment." That regulation will be separately discussed. There is no doubt that the regulation is part of the federal law which controls national banks, but there is likewise no doubt that the regulation is not itself a "provision" of the statute. The Respondents did not violate 12 U.S.C. §24 Seventh.

B. 12 U.S.C. §82

Section 82 was a provision of Chapter 2 which limited the total outstanding indebtedness for which a national bank could be liable at any time. It was often called the "borrowing limit." In general, the borrowing limit could not exceed the bank's unimpaired paid-in capital stock plus 50% of its unimpaired surplus. (The text printed in Petitioner's Appendix is incomplete, omitting the clause as to surplus.) The parties stipulated balance sheets and quarterly reports showing that CNB's borrowing limit under §82 ranged from about $71 million on December 31, 1979 to about $76 million on December 31, 1980. That limit was far less than the $307 million in bond purchases in 1980.

The parties stipulated that the money used to purchase the added securities all came from two sources, Federal

Funds Purchased (called "Fed Funds") and Sale and Repurchase Agreements (called "Repos"). The issue presented to the trial court at the time the original Complaint was filed was whether Fed Funds and Repos were to be treated as contracts of purchase and resale (the Fed Fund transaction), as contracts of sale and repurchase (the Repo transaction), or whether both types of transactions were to be treated as borrowing and indebtedness subject to the limitation of 12 U.S.C. §82.

Seven days after the Complaint was filed, 12 U.S.C. §82 was repealed in its entirety by the Garn-St. Germain Depository Institutions Act of 1982. (Pub. L. No. 97-320, Title IV, §402, 96 Stat. 1510 (Oct. 15, 1982)). The District Court applied the rule that the law in effect at the time of decision is the law of the case. The Court of Appeals affirmed. This rule has been the law of the United States since 1801 when Chief Justice Marshall stated the principle in *United States v. Schooner Peggy*, 1 Cranch 103, 110. In *Bradley v. School Board of City of Richmond*, 416 U.S. 696, 711 (1974), the Supreme Court restated the proposition saying that:

> "A court is to apply the law in effect at the time it renders its decision, unless doing so would result in manifest injustice or there is statutory direction or legislative history to the contrary."

Both lower courts agreed that the exception did not apply because there was no injustice in recognizing the repeal of a statute which the defendants had not violated in the first place. Both Federal Reserve regulations and the Comptroller's regulations interpreted the effect to be given Fed Fund and Repo transactions. All the CNB transactions in 1980 were in complete harmony with those regulations and in accord with the "Comptroller's Manual for National Banks."

Up until 1965 the Comptroller instructed national banks to include Fed Funds and Repos within the borrowing and lending limits. The Comptroller reversed this ruling and published his new rules in the 1965 Manual as ¶1130 and ¶1131. These were first published in the Federal Register in 1971, as 12 C.F.R. §7.1130 and §7.1131. They remain unchanged. Both of them are referred to in a later expanded rule, 12 C.F.R. §7.7518, which provides:

> "For purposes of 12 U.S.C. 82, a national bank's indebtedness or liability does not include Federal Funds Purchased (see §7.1130), obligations to repurchase securities sold (see §7.1131), or bills payable to the Federal Reserve (12 U.S.C. 82(5)). * * *."

There is no reason for this Court to review again the principle it announced in *Udall v. Tallman,* 381 U.S. 1, 16 (1965) that "when faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration." The Respondents did not "knowingly violate" 12 U.S.C. §82.

C. 12 U.S.C. §84

This code provision is commonly known as the "lending limit." It provides in general that a national bank cannot lend to any one person or entity at amount which would make the particular borrower's total obligation to the bank exceed 10% of the bank's combined unimpaired capital and surplus. In the case of CNB in 1980, the 10% lending limit averaged about $14 million, based on stipulated balance sheets.

Petitioner's theory is that the Incremental Securities Portfolio Program of CNB in 1980 would have benefited Centran if CNB had made its expected profit. Centran

had the power to issue Repos and the power to buy bonds for its own account, but never did so. Centran was not a member bank of the Federal Reserve system and had no power to purchase Fed Funds. CNB did use Fed Funds to buy part of the portfolio. The whole bond program, it is argued, was for the benefit of Centran and was, therefore, "in effect and in substance" a loan from CNB to Centran when CNB did what Centran could not do.

The parties stipulated:

> "During 1980 CNB did not in fact make any loans to Centran, and did not in fact transfer to Centran any monies except for dividend payments on its common stock. * * *
>
> "Although plaintiff concedes there was not in fact any loan from CNB to Centran which might violate 12 U.S.C. 84 or 12 U.S.C. 376b, plaintiff maintains its contention that the securities purchased by CNB were 'in effect or in substance' loans from CNB to Centran."

The District Court's opinion dismisses the notion that an imaginary loan can constitute an actual violation of Section 84 with the adjective "inconceivable." The Court of Appeals agreed that Petitioner's theory was inconceivable and added that "Marx has not advanced, nor can we discover, any coherent argument for treating these transactions as loans to Centran."

It can be added here that the "loan" theory is not confined to 12 U.S.C. §84. In the lower courts the plaintiff argued that the hypothetical loans were loans to "insiders" in violation of the 1978 amendment to the Federal Reserve Act, 12 U.S.C. §375b. Petitioner made an additional claim that since CNB and Centran were affiliated, CNB also violated the terms of 12 U.S.C. §371c, which regulates

loans from a member bank of the Federal Reserve to an affiliate. There is little point in discussing the specific provisions of Sections 375b and 371c when no actual loan was ever made.

D. 12 U.S.C. §93(a)

Section 93(a) is the recodification in 1978 of the original §93 of the National Banking Act, first enacted in 1864. It deals entirely with "knowing violations" of those sections of the Act which are "provisions of this chapter," meaning original Chapter 2. It applies only to directors of national banks, and accordingly cannot apply to those few Respondents who were only officers of CNB. There is no dispute that §93(a) makes directors liable in their personal and individual capacity "for all damages which the association, its shareholders, or any other person, shall have sustained."

This section gives CNB, the association, a direct action against its own directors. It gives Centran, as sole "shareholder," a direct action against the CNB directors. It does not specifically grant a direct cause of action to the shareholders of the holding company.

This raised the question whether Marx was included in the category of "any other person" who would have a direct action under §93(a). The trial court treated Marx as though he were a shareholder of a national bank, but found there had been no violation of any Chapter 2 provision of the statutes. The Court of Appeals affirmed on this point, and if certiorari were granted, this Court would surely affirm that the facts disclose no violation of 12 U.S.C. §24 Seventh, nor 12 U.S.C. §82, nor 12 U.S.C. §84. This ends the possibility of a direct action, whether individual, class, or derivative, under the private enforcement rights granted in §93(a).

Reason 2. There Is No Reason to Grant the Writ to Determine Whether a Private Right of Action Can Be Implied Under 12 U.S.C. §93(b).

The new subsection 93(b) was added to 12 U.S.C. §93 in a 1978 amendment to the National Bank Act. It created a comprehensive eight-part procedure whereby the Comptroller could impose a civil penalty of $1,000 a day for any violation of "any of the provisions of this title * * * or any regulation issued pursuant thereto." The penalty could be imposed against the association itself, or any officer, director, employee, agent or other person participating in the conduct of the association's affairs. The Comptroller alone could determine the amount of the penalty, taking into account the size of resources and the good faith of the person charged, the gravity of violation, and history of previous violations, and "such other matters as justice may require."

The Comptroller, in his sole discretion, may "compromise, modify or remit any civil money penalty which is subject to imposition or has been imposed under this section." All civil penalties collected must go, not to the persons damaged, but "into the Treasury of the United States." There is not a single sentence in all the eight subparagraphs of §93(b) which even hints at any private right of action or private enforcement.

The text of 12 C.F.R. §1.4 permits a national bank to purchase Type I securities for its own account "subject only to the exercise of prudent banking judgment." It defines the adjective "prudent," as the Comptroller meant it, by stating: "Prudence will require such determinations as are appropriate for the type of transaction involved." Respondents concede, for the purpose of this lawsu... and

its appeals, that the Comptroller could have determined that it was not prudent banking judgment for CNB to create such a large addition of long maturity bonds in 1980 supported by such short term liabilities as Fed Funds and Repos. There is not much risk when the assets and the liabilities mature at the same time and the return on the assets will pay off all the liabilities. There is risk when there is a gap, in either direction, between the maturities of the assets and the supporting liabilities.

Assuming, as this Court will surely assume, that the Comptroller could have made charges, held hearings, and might have imposed civil penalties against the individual Respondents, it does not follow that a private Centran shareholder can imply a private enforcement right for damages payable to himself, or to the class of Centran shareholders, or to Centran or CNB in a derivative action. The Courts below have held that the Comptroller has the exclusive power to enforce 12 U.S.C. §93(b), in complete accord with all the recent Supreme Court decisions on private rights of action. This Court has no reason to re-examine the private right of action issue in light of its decision in *Cort v. Ash*, 422 U.S. 66, 78 (1975) and the elaboration and refinement of the *Cort v. Ash* factors in the following cases, among others: *Touche, Ross & Co. v. Reddington*, 442 U.S. 560, 568 (1979); *Transamerica Mortgage Advisers, Inc. v. Lewis*, 444 U.S. 11, 15-16 (1979); *Universities Research Assoc. v. Coutu*, 450 U.S. 754, 770 (1981); *Texas Industries, Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 639 (1981); and *Jackson Transit Authority v. Amalgamated Transit Union*, 457 U.S. 15, 21 (1982).

The Respondents cannot be held liable to the Petitioner under 12 U.S.C. §93(b).

Reason 3. There Is No Reason to Grant the Writ to Determine Any Issue Under 12 U.S.C. §371c, 12 U.S.C. §375b, 12 U.S.C. §501a or 12 U.S.C. §503.

12 U.S.C. §371c is published at A53 in Petitioner's Appendix. It deals with the limitations and restrictions on loans and certain other covered transactions between affiliates. CNB and Centran were affiliates. The nonsense claim that CNB's bond purchases were "in effect" loans to Centran has already been analyzed.

12 U.S.C. §375b prohibits loans among or for the benefit of "insiders" and "control" persons. It cannot be violated when there is no loan at all. Petitioner refers to this section only in passing, saying that both Courts below held that a "constructive loan could not be inferred" between the bank and its holding company. (Brief at 23.) That decision is correct.

Petitioner's Appendix publishes the text of 12 U.S.C. §501a and §503. These are enforcement sections included within the Federal Reserve Act, which might apply if §§371c and 375b of the Federal Reserve Act had been violated by a real loan among "insiders" or affiliates. Neither §501a or §503 could possibly apply to a violation of the Rule of Prudence or any other regulation of the Comptroller.

Reason 4. There Is No Reason to Grant the Writ to Review Any Issue Respecting Pre-emptive Rights, the MMBI Transaction or Section 1842(d) of the Bank Holding Company Act.

A. Facts on the issue of pre-emptive rights.

Centran was incorporated in Delaware in 1970 with a charter, by-laws, and common shares which did not give

any pre-emptive rights to any Centran shareholder. It did no business until its merger with Central National Bank of Cleveland in 1971. The Articles of Association of the bank, CNB, provided that no shareholder of the capital stock of the Association "shall have any pre-emptive or preferential right." In the 1971 merger, each shareholder in CNB surrendered his shares in the Association for an equivalent number of shares of Centran common. The bank shareholders, with no prior pre-emptive rights, became holding company shareholders, with no future pre-emptive rights. Dissenters were paid fair value.

Centran acquired 97% of the stock of American Bank of Commerce in Akron, Ohio by direct purchase in 1972. Centran raised the purchase money by a public issue of additional common stock. This required a Prospectus, registered with the S.E.C. in 1972. The Prospectus stated: "There are no * * * pre-emptive rights with respect to Centran's Common Stock."

Centran stock was regularly traded in the stock market. Marx bought 200 shares in a market trade in 1978. It is not known which his particular shares came from an original CNB shareholder who acquired his Centran stock in the 1971 merger, or came from a purchaser of the additional issue in 1972. In either case, the seller was a shareholder who must have known there were no pre-emptive rights.

Petitioner claims a securities fraud in that the Centran directors did not give special notice to the merging CNB shareholders that they had no pre-emptive rights before or after the merger. If this violated 15 U.S.C. 77q and 78j in 1971, limitations barred any action after four years. There is no claim of nondisclosure with respect to the new issue of stock sold in 1972.

Petitioner seems to claim that Centran should have notified Marx that his shares would have no pre-emptive rights before his purchase in 1978, but Petitioner fails to suggest any duty on anyone to anticipate that Marx would become a market trader. It is apparent that Marx never purchased pre-emptive rights, never purchased a cause of action for nondisclosure of pre-emptive rights, and never exercised any diligence in 1978 to determine whether pre-emptive rights came with the stock.

Although Petitioner claims that the 1971 merger was a "contract" between Centran and its 1971 shareholders which was not "breached" until 1982, Petitioner makes no coherent argument as to how any contract with Marx existed to be breached.

B. The facts on the MMBI transaction.

In the 1982 recapitalization Centran raised $70 million in equity money by selling a new issue of nonvoting preferred stock to MMBI. Centran then infused $55 million into CNB by buying a new issue of CNB preferred. In the absence of pre-emptive rights the new preferred stock issues were completely within the powers of the respective boards of directors and required no stockholder approval or Federal Reserve Board approval.

MMBI was itself a Delaware bank holding company with all of its banking subsidiaries located in the State of New York. Under Ohio law at the time MMBI could acquire no controlling interest in CNB. That is still the law of Ohio, and MMBI still has no controlling interest in CNB or in Centran. MMBI would be deemed to have "control" over Centran or CNB only if MMBI directly or indirectly owned, controlled, or had power to vote 25% or more of any class of *voting securities* or to control the election of a majority of the directors of Centran or CNB (12 U.S.C. §1841(a)(2), Definitions).

Petitioner invents "control" by representing to this Court that the nonvoting preferred stock issued to MMBI carried warrants allowing conversion into Centran voting common stock, and that such warrants were "exercisable in January 1985." The representation is false. The warrants were highly conditioned, and are not presently exercisable at all. They cannot be exercised, by their terms, until interstate banking becomes legal. Ohio law still prohibits a foreign holding company from acquiring a more than 5% voting interest in another bank holding company doing business in Ohio with its banking subsidiaries in Ohio. Federal law still permits Ohio to maintain its exclusionary law.

C. 12 U.S.C. §1842(d).

Petitioner claims a right of action for violation of 12 U.S.C. §1842(d), which is a provision of the Bank Holding Company Act. Section 1842(d) prohibits a holding company such as MMBI from acquiring, "directly or indirectly, any voting shares of, interest in, or all or substantially all of the assets of any additional *bank*" located out of state. CNB is such a bank. Centran is not a bank. MMBI acquired no interest in CNB. Section 1842(d) itself allows MMBI to acquire such an interest by acquiring *voting* shares of Centran whenever such acquisition is specifically authorized by Ohio law. Since Ohio law has not yet changed, MMBI still cannot acquire more than 5% of the voting shares, and cannot violate §1842(d).

The District Court held that §1842(d) was not violated. The Court of Appeals did not reach that question, holding instead that even if §1842(d) were violated, plaintiff Marx would have no private right of action. The trial court had reached the same conclusion, as an alternative theory justifying dismissal, and was affirmed on that point.

This Court would necessarily affirm, if the writ were granted. The exclusive federal remedy for violation of §1842(d) is contained in the criminal penalty provisions of §1847(a), or the civil penalty procedure of §1847(b) which can be administered only by the Federal Reserve Board. The lower court opinions properly equate §1847(a) and (b) with 12 U.S.C. §93(b) with respect to all the Supreme Court decisions following the rule of *Cort v. Ash, supra.*

Reason 5. The Facts of This Case Present No Genuine Constitutional Issue.

It is risky to try and paraphrase a Petitioner's point when the Respondents do not fully understand what the Petitioner is trying to say. As Respondents read it, Petitioner is claiming a violation of the Fifth Amendment in that the "shareholders' private property has been taken for public use, without just compensation, and without due process of law, prohibited by Amendment 5 of the United States Constitution." (Brief, at 26.)

The premise of the argument is that shareholders have a contractual right "to control their corporation." Part of the contract is the director's implied agreement to be prudent. Unless the shareholders have a private right of action to collect damages from the directors for imprudent bond purchases the shareholders' right of control "has been converted to public use."

The basic fallacy is that shareholders do not have the right to control the corporation's business affairs. They elect directors, who are the executive representatives of the corporation. They derive their powers from the corporate code and the corporate charter. The stockholders neither confer, revoke, nor interpret those powers.

This is certainly the plan of the National Bank Act, which provides that "the affairs of each association shall be managed by not less than five [nor more than twenty-five] directors who shall be elected by the shareholders * * *." 12 U.S.C. §§71, 71a. "Each director must take oath that he will diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of this title * * *." 12 U.S.C. §73.

There is no oath that the director can never make an error of business judgment. It follows that directors can buy as many U.S. bonds as Congress has authorized in 12 U.S.C. §24 Seventh, subject to supervisory control by the Comptroller of the Currency. Congress has not given shareholders a private right of action to enforce the Comptroller's regulations. Petitioner has no "private property" rights in the national banking system regulatory plan, and has lost nothing which requires compensation.

Petitioner cites *First National Bank v. National Exchange Bank*, 92 U.S. 122 at 127 (1875), which does say that the incidental powers of a bank are intended to allow it to "conduct its affairs * * * safely and prudently." It also says that banks may incur liabilities and obligations, and that "obligations may be assumed that result unfortunately." (92 U.S. at 127.) The opinion nowhere says that all borrowing must be "safe, prudent and temporary," as Petitioner claims. (Brief, p. 18.)

It is preposterous to claim that the Federal Courts can review every national banking system statute enacted by Congress and every regulation promulgated by the Comptroller to determine whether they meet a Supreme Court superior standard of "safety and prudence." On the other hand, the Federal Courts do not hesitate to intervene when

the Comptroller or the Board *exceeds* the regulatory power delegated by Congress. Such cases do not indicate that the Supreme Court has an ultimate regulatory power. On the contrary, those cases necessarily recognize that the Constitution vests all legislative powers in the Congress of the United States.

In summary, all of the constitutional issues raised by Petitioner were settled more than a century ago when the Supreme Court held that national banks are created by Congress, and are instruments of national government. *Bank of Bethel v. Paquioque Bank*, 81 U.S. 383 (1872). The power of Congress over national banks is paramount. *McCulloch v. Maryland*, 4 Wheat 316 (1819); *First Nat. Bank v. Walker Bank & Trust Co.*, 385 U.S. 252, 256 (1966). Congress has absolute authority over national banks. *First Nat. Bank v. Dickinson*, 396 U.S. 122, 131 (1969).

There is no reason for this Court to grant the writ to review the power of Congress to limit private shareholder's derivative lawsuits.

Reason 6. There Is No Reason for This Court to Review the Trial Court's Discretion in Dismissing Without Prejudice the Pendent State Claim.

If Petitioner really has a state court cause of action, he could have filed in the state court in Ohio at any time after January 1, 1981. The District Court's order did not diminish that right. It must be emphasized that the dismissal occurred early in the Federal Court proceedings, after the Amended Complaint, before Answer, following intensive voluntary discovery which used little court time or court resources. There is no judicial economy in compelling the District Court to take the state court case through full trial after all the federal issues have been

dismissed. The leading case remains *United Mine Workers v. Gibbs,* 383 U.S. 715 (1966), where this Court suggested that "if the federal claims are dismissed before trial, even though not insubstantial in a jurisdictional sense, the state court claims should be dismissed as well." (383 U.S. at 726.)

IN ANSWER TO PETITIONER'S BRIEF

A. Response as to facts.

In view of all the stipulations, Petitioner is not entitled to such gaudy distortions as his claim that the directors "bet the bank" (p. 18, 56); bought bonds "on margin" (p. 28); or bought bonds with $307 million in borrowed funds "rolled over daily for 3 years" (pp. 7, 18, 21). The bank was never in danger of insolvency or failure. The 1980 year began with a surplus of about $128 million and ended with a larger surplus. Every bond was purchased outright with payment in full. There were no short or long sales or purchases. The purchase program lasted only one year. CNB began with an established portfolio of more than $560 million in United States and State obligations. The incremental purchasing program in 1980 increased the total to $867 million. Liquidation began in January, 1981 and sold off $195 million, nearly two-thirds of the $307 million incremental addition by the end of 1981.

The bond program was only one of many business programs in a bank that had over $1.7 billion in demand and time deposits and NOW accounts. Petitioner's claim that it is "speculative" to buy bonds in excess of capital and surplus (p. 28) makes no accounting sense. If a

bank with $1 million in surplus bought $10 million in bonds (assets) with $10 million in borrowed funds (liabilities), the assets would offset the liabilities and the bank would still have $1 million in surplus. The bank could put all of its depositors funds in U.S. bonds, except for Reserve requirements.

The essence of Petitioner's claim is that the creation of a negative gap between long-term maturing assets and short-term liabilities created the risk that short-term interest might exceed the long-term interest rates of the assets. That risk might make the investment program imprudent, in violation of the Rule of Prudence, 12 C.F.R. §1.4. Petitioner's dilemma is that if the bond purchases were not "prudent," the Comptroller has the exclusive enforcement power to impose a civil penalty. If, on the other hand, the program was "prudent," there would be no violation of 12 C.F.R. §1.4. At the same time, state law would provide no cause of action for "prudent" losses.

B. Response to Petitioner's case law.

Petitioner argues that *Gries Sports Enterprises, Inc. v. Modell,* 15 Ohio St. 3d 284 (1984), establishes a new principle—that Ohio corporate law "controls the internal affairs of Centran" (p. 35) rather than Delaware corporation law. The decision held only that Ohio's conflict of law rules would apply in a breach of contract suit over a contract between two Ohio shareholders. Under the facts of the case, Ohio law was held to control the contracting parties' voting trust agreement. The opinion does not suggest that Ohio shareholders in all foreign corporations have any management control powers under Ohio's corporation code.

C. Response to Petitioner's Reason No. 4.

Petitioner's fourth reason for granting the writ is a claim of conflict between decisions in the Sixth and Seventh Circuit on the issues of standing and devolution by operation of law. There is no record before this Court to support the claim of conflict. There is no motion pending in this Court to substitute Donald Marx, Executor, as party plaintiff. There is no motion in this Court to abate or dismiss the derivative counts in Petitioner's action.

Petitioner relies on *Hirshfield v. Briskin,* 447 F.2d 694 (7th Cir., 1971). There the plaintiff widow renounced her decedent's will and testamentary trust and elected to take by statute. Her stock ownership arose from the settlement of the lawsuit disputing her right to take by statute. It was held that such ownership approximated acquisition by inheritance which would be devolution by operation of law.

In the instant case there is no dispute over the basic fact that Sylvester Marx conveyed his entire securities portfolio to the trustee of his inter vivos trust before his death. The portfolio consisted of 64 certificates representing 5,614 shares of stock in 23 corporations, including 1 certificate for 200 shares of Centran. Marx made the transfer deliberately and intentionally, at the urging of his son Donald, who assisted him in making the transfer.

Petitioner's counsel waited three months after Marx's death to file a formal suggestion of death, and then moved the Court of Appeals *not* to appoint the Executor as substitute party plaintiff until that court had first ruled on a collateral attack on the state probate proceedings and the trust funding transaction. A bitter dispute arose between appellant and appellees over the facts of the trust

and the funding transaction, shown in affidavits, counter-affidavits, and a recanting affidavit.

Meanwhile, the Court of Appeals had affirmed the summary judgment below and had denied rehearing. There was no case left to dismiss. The tenuous retained jurisdiction of the appellate court to rule on the collateral attack depended upon a stay of mandate. The stay expired and the within petition for writ of certiorari was filed before the Court of Appeals could sort out the facts, much less rule on the law. Petitioner's Reason 4 urges this Court to take over the collateral attack left unresolved below and order Respondent Centran to reissue Marx's original stock certificate for delivery to the Executor of his estate. This remains his condition precedent to any consideration of the substitution question.

Respondents suggest that before a reviewing court is requested to rule on such an issue, responsible counsel have a duty to agree upon an honest presentation of the facts. Petitioner's counsel here persists in representing Marx's trust as an "insurance trust" (p. 50, 53) and claims its terms "precluded on its face the acceptance of stock as part of the trust" (p. 53). The claim is disgraceful. The trust agreement, stipulated, says in Article I that it consists of the property listed in the attached schedule. The schedule lists the whole corpus as "Cash in the amount of $10.00." The trust agreement in Article VI reserved the right to add property to the trust estate at any time. Article I also allowed Marx to deposit insurance policies, payable to the trustee. The last "Brief to Clarify" and correcting affidavit of Donald Marx below concedes there is no evidence Marx still owned a single insurance policy at the time he created the trust in 1980. It is established now that he never deposited insurance

policies in the trust, never withdrew policies from the trust, and never bought stock from the cash value of any insurance policy.

The issue of standing relates only to the derivative claims. The Marx Estate would retain rights to direct action claims for his own individual damages. Resolution of the standing issue can wait until this case is remanded to a trial court, if that ever happens. A trial court will have the facilities to resolve the factual dispute in short order. If, on the other hand, this Court denies the petition for writ of certiorari on its merits, or lack of merit, the entire case will end. Respondents are convinced that the writ ought to be denied on the pure ground that there is no error in the decisions below and no conflict with this Court's controlling decisions as to private right of action. Accordingly, Respondents will not at this time suggest the death of plaintiff Marx nor move for substitution. Sylvester Marx petitioned for the writ, and it can be granted or denied in his name.

CONCLUSION

There are neither special nor important reasons to review this case. Every question of federal law involved has been decided in full accord with applicable decisions of this Court. Although this Court has not directly settled the question whether 12 U.S.C. §93(b) gives a private right of action, this Court has repeatedly held that the intent of Congress controls that issue. The decisions of the trial court and Appellate Court case were based squarely on the test factors promulgated by this Court

for determining Congressional intent. The petition for writ of certiorari should be denied.

Respectfully submitted,

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